

## PUBLIC UTILITIES COMMISSION

505 VAN NESS AVENUE  
SAN FRANCISCO, CA 94102-3298

**FILED**

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July 6, 2006

Agenda ID #5823

TO: PARTIES OF RECORD IN APPLICATION 06-05-005

This is the draft decision of Administrative Law Judge (ALJ) Galvin. It will appear on the Commission's July 20, 2006 agenda. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Pursuant to Rule 311(g)(2) and Rule 77.7(g), parties have stipulated to reduce the 30-day comment period to five days. Comments on the draft decision are due on July 11, 2006.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at [www.cpuc.ca.gov](http://www.cpuc.ca.gov). In addition to service by mail, parties should send comments in electronic form to those appearances and the state service list that provided an electronic mail address to the Commission, including ALJ Galvin at [mfg@cpuc.ca.gov](mailto:mfg@cpuc.ca.gov). Finally, comments must be served separately on the Assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious methods of service.

/s/ ANGELA K. MINKIN by PSW

Angela K. Minkin, Chief  
Administrative Law Judge

ANG:tcg

Attachment

Decision **DRAFT DECISION OF ALJ GALVIN** (Mailed July 6, 2006)

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

Application of California-American Water Company (U 210 W) (1) to issue, sell and deliver to one or more affiliated entities not exceeding in the aggregate \$187,000,000 of any combination of (a) shares of its common stock and (b) debt securities consisting of long term notes; and (2) exempting the issuance, sale and delivery of such stock and debt securities from the Commission's competitive bidding rule.

Application 06-05-005  
(Filed May 5, 2006)

**OPINION AUTHORIZING THE ISSUANCE OF  
DEBT AND COMMON STOCK**

**I. Summary**

This opinion grants California-American Water Company (California American Water) the authority to issue any combination of long-term debt and common stock to the extent that the total amount issued does not exceed \$187 million.

California American Water is exempted from the Competitive Bidding Rule in the issuance of its long-term debt. The reasonableness of the resultant interest rate and cost of money to the utility is subject to scrutiny in California American Water's cost of capital proceedings. In that regard, California American Water shall provide testimony in such a proceeding that substantiates the reasonableness of its interest rates applicable to the financing approved in this order.

**II. Background**

California American Water is a public utility corporation engaged principally in the business of providing water service in portions of the counties of Los Angeles, Ventura, San Diego, Monterey, Sacramento, Placer, Santa Cruz, and Sonoma. Its principal place of business is at 303 H Street, Chula Vista, CA.

**III. Request**

California American Water seeks authorization to issue, sell and deliver for cash during the next twelve months any combination of its long-term notes and shares of its common stock to one or more affiliated entities in an aggregate amount not to exceed \$187 million. California American Water also seeks an exemption from the Commission's competitive bidding rule.

**IV. Discussion**

California American Water used its projected construction budget for 2006 to determine its future financing needs. That forecast includes uses of funds such as capital expenditures and maturing debt obligations, and sources of funds including cash flow from operations, as detailed in Exhibit H to the application. It projects that it will need \$187 million in addition to its projected cash flow to meet its construction needs and to replace debt used for capital improvements.

California American Water currently has \$46 million of First Mortgage Bonds, encumbered by its properties, previously authorized by the Commission as detailed in the application. It has \$132 million of unsecured debt in the form of Notes Payable to American Water Capital Corporation (AWCC) which were issued pursuant to D.00-10-067, and as modified by D.01-08-055 and D.01-09-002. It also has \$24 million of short-term debt owed to AWCC for the construction, completion and improvement of California American Water's facilities. Notes payable that are part of this application will be refinanced as they become due in

the ordinary course of business. The only exception will be the refinancing of an \$8 million note payable that will not come due until 2033. The latter note will be refinanced as part of this application due to a pending divestiture of American Water Works from RWE Aktiengesellschaft (RWE).

All of its long-term debt and common stock previously authorized by the Commission has been issued. Hence, California American Water seeks authorization to issue new long-term debt and common stock to one or more affiliated entities in an aggregate amount not to exceed \$187 million to meet its 2006 financing needs.

The long-term notes will be issued pursuant to a Financial Services Agreement with AWCC, an affiliated entity whose purpose is to provide financing to American Water Works Company, Inc. and to the latter's regulated subsidiaries, including California American Water. Financial Services Agreements similar to the one attached to the application as Exhibit F has been approved by this Commission.<sup>1</sup>

California American Water Company represents that it will maintain a capital ratio of approximately 60% debt to 40% equity that is consistent with its Indenture, D.05-09-020, its policies, and policies of its Parent Company.<sup>2</sup>

California American Water also represents that it will continue to follow the business practices relating to the inter-company debt and equity financing transactions as approved in D.02-12-068 and D.00-10-067. Those business practices include established procedures for prompt and fair compensation or

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<sup>1</sup> See for example, D.00-10-067 (2000) *mimeo.*, p. 12.

<sup>2</sup> Paragraph 4.5 on page 6 of the application.

reimbursement for financing transactions between the Utility, Parent Company and AWCC; reasonable assurance that California American Water is able to maintain its financial strength so as to reasonably fulfill its public utility obligations; and, permit the Commission to fulfill its regulatory responsibilities.

The terms of borrowing under the Financial Service Agreement will be as follows:

- Notes may be issued up to the aggregate authorized amount.
- Maturities not more than 30 years from the date of issue, with the expectation that the maturity dates can be from 1 to 30 years, depending upon market conditions.
- Interest rates will be determined by market conditions.
- Interest payable on the day prior to the dates on which AWCC must pay its corresponding interest payments on the borrowings from which the proceeds of the loan were derived. This is expected to be monthly, quarterly or semiannually and is subject to final negotiation.
- No taxes on Notes are assumed by issuer.
- The Notes will be unsecured.
- The Notes will have the same call ability features that AWCC obtains in connection with its borrowings from which the proceeds of the loans are derived. The Notes will have no conversion features.
- No maintenance and depreciation requirements unless the borrowings are made on a tax-free basis.
- The Notes will reflect whatever terms AWCC can obtain from its lenders. Normally there will be no sinking or other fund provisions.

California American Water intends to apply \$30 million of the net proceeds from the proposed issuance of \$187 million debt and common stock for the expansion and betterment of utility plant; \$24 million of short-term debt

owed to AWCC used for construction, completion, and improvement of California American Water's facilities; and, \$132 million for the retirement and replacement of the previously authorized Notes Payable to AWCC. It expects that approval of its securities request will provide it with sufficient flexibility to meet its financial and service obligations.

### **A. Approval**

California American Water's request to issue long-term debt and common stock is subject to §§ 816, *et seq.* of the Public Utilities Code.<sup>3</sup> The Commission has broad discretion under §§ 816, *et seq.* to determine if a utility should be authorized to issue debt and common stock. Where necessary and appropriate, the Commission may attach conditions to the issuance of debt and common stock to protect and promote the public interest.

#### **1. Issuance of Securities**

California American Water has substantiated that its \$187 million securities request is necessary to satisfy its 2006 needs for financing capital expenditures, acquiring property, and retiring or refunding previously authorized long-term debt. These purposes are authorized by § 817 and, as required by § 818, are not reasonably chargeable to operating expenses or income. Therefore, we will grant California American Water authority under § 816, *et seq.* to issue to its requested long-term debt and common stock for the aforementioned purposes, as detailed in the application.

Consistent with § 824, California American Water shall maintain records to identify the specific long-term debt and common stock issued

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<sup>3</sup> All statutory references are to the Public Utilities Code unless otherwise stated.

pursuant to this Opinion, and demonstrates that proceeds from such debt and common stock have been used only for the purposes authorized by today's Opinion.

California American Water may allocate the authorized debt and common stock among the authorized purposes as it deems necessary. California American Water may also issue any combination of long-term debt and common stock, as long as the total amount issued pursuant to this Opinion does not exceed \$187 million, and the selected combination results in a capital structure that complies, on average, with the Commission-adopted capital structure during the period the adopted capital structure is in effect for ratemaking purposes.

## **2. Competitive Bidding Rule Exemptions**

Resolution F-616, issued on October 1, 1986, requires utilities to issue debt using competitive bids. The purpose of this requirement, known as the Competitive Bidding Rule, is to reduce the cost of debt issued by utilities. The Resolution also provides for utilities to seek an exemption from the Competitive Bidding Rule for debt issues when competitive bidding is not viable or available.

California American Water has no bond rating making it very difficult, if not impossible, and costly to issue debt through a competitive bidding process. Hence, it seeks an exemption from the Competitive Bidding Rule with respect to issuing long-term notes so that it may negotiate issues of long-term debt through a Financial Services Agreement, as more fully described under Exhibit F attached to the Application.

California American Water's request for an exemption from the Competitive Bidding Rule is granted on the basis the request is consistent with the terms of Resolution F-616; the Commission has routinely granted California

American Water and other utilities similar exemptions and modifications<sup>4</sup> with no discernable adverse impacts on the utilities, their customers, or the public at large; and, on California American Water's representation that granting the exemptions and modifications will enable it to obtain debt in a manner advantageous to California American Water and its ratepayers.

However, we make no finding regarding the reasonableness of the rates, terms, and conditions of debt issued by California American Water pursuant to the exemption granted herein. The reasonableness of the resultant interest rate and cost of money to the utility is subject to scrutiny in California American Water's cost of capital proceedings. In that regard, California American Water should provide testimony in such a proceeding that substantiates the reasonableness of its interest rates applicable to the financing approved in this order.

### **3. Reporting Requirement**

General Order (GO) 24-B requires utilities to submit a monthly report to the Commission that contains, among other things: (i) the amount of debt and stock issued by the utility during the previous month; (ii) the total amount of debt and stock outstanding at the end of the prior month; (iii) the purposes for which the utility expended the proceeds realized from the issuance of debt and stock during the prior month; and (iv) a monthly statement of the separate bank account that the utility is required to maintain for all receipts and

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<sup>4</sup> See, for example, D.04-10-037 (2004) *mimeo.*, pp. 50 and 51; D.03-12-004, *mimeo.*, pp. 32 and 33; and, D.03-7-008 (2003) *mimeo.*, p. 27.



disbursements of money obtained from the issuance of debt and stock.

California American Water shall comply with GO 24-B.

## **V. Fee**

Whenever the Commission authorizes a utility to issue debt and preferred stock, the Commission is required to charge and collect a fee pursuant to §§ 1904(b) and 1904.1. A fee is not applicable on any such issues used to guarantee, take over, refund, discharge, or retire any stock, bond, note, or other evidence of indebtedness on which a fee has theretofore been paid to the Commission. (§ 1904.1).

California American Water requests that it be charged a fee on only \$55 million of its \$187 million debt and stock authorization request. This is because California American Water intends to use the remaining \$132 million of its requested debt and stock instruments to retire or refund securities previously issued. California American Water calculated the fee to be \$33,500, as detailed in Schedule 4 of its Exhibit H to the application.

California American Water shall remit the \$33,500 fee to the Commission's Fiscal Office.<sup>5</sup> However, if California American Water actually uses any of the \$132 million earmarked for other than for the retirement or refund of securities previously issued, it should notify the Commission in writing and pay the corresponding fee.

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<sup>5</sup> The fee is assessed on \$55 million of the authorized \$187 million debt and common stock as follows: (\$2 times (\$1,000,000/\$1000) plus (\$1 times \$9,000,000/\$1,000) plus (\$0.5 times \$45,000,000 equals \$33,500. The remaining \$132 million of the total \$187 million debt and common stock securities being authorized is excluded from the fee calculation to the extent California American Water uses that debt and common stock to retire and refund securities previously charged a fee.

The authority granted by this order shall not become effective until California American Water remits the \$33,500 fee to the Commission's Fiscal Office.

## **VI. California Environmental Quality Act**

Under the California Environmental Quality Act (CEQA) and Rule 17.1 of the Commission's Rules of Practice and Procedure (Rules), we must consider the environmental consequences of projects that are subject to our discretionary approval.<sup>6</sup> Thus, we must consider whether approval of this application will alter an approved project, result in new projects or change operations in ways that have an environmental impact.

The requested authority to issue any combination of long-term debt and common stock does not have any significant adverse effect on the environment.

On §§ 816, et seq. applications, the Commission must act as either a Lead or Responsible Agency under CEQA. Generally, the Lead Agency is the public agency with the greatest responsibility for supervising or approving the project as a whole (CEQA Guideline Section 15051(b)). CEQA requires that a Responsible Agency consider the Lead Agency's Environmental Impact Report, Negative Declaration or Mitigated Negative Declaration prior to acting upon or approving a project (CEQA Guideline Section 1505(b)). The specific activities that must be conducted by a Responsible Agency are contained in CEQA Guideline Section 15096.

In this Application, the Commission is making a discretionary decision and, where CEQA applies, must act as either a Lead or Responsible Agency. On

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<sup>6</sup> Pub. Resources Code Section 21080.

the facts, here, however, CEQA does not apply, because the decision to approve California American Water's Application is not a project within the scope of CEQA. Here California American Water has not asked for approval of any specific projects, nor is this financing Order authorizing any specific capital expenditures or construction projects.

It is unknown at this time what the specific project activities and new construction associated with the authority to issue debt will be. The Application specifies that the purpose of the Application is to secure authority to issue debt to have the flexibility to meet financial and service obligations. This includes expansion and betterment of utility plant, acquisition of property, and reimbursement for money expended for those purposes.

Since the details of proposed improvements are unknown at this time, we will approve the debt financing and place California American Water on notice that the approval of the debt requested in the Application does not constitute an implied or expressed waiver of applicable environmental regulations.

This financing order will not authorize any capital expenditures or construction projects. California American Water will not use the proceeds authorized by this order to begin construction of capital projects until California American Water has obtained the required approvals from the Commission, if any, including any required environmental review under CEQA.

## **VII. Protest**

The Division of Ratepayer Advocates (DRA) tendered a June 28, 2006 late-filed protest and companion motion to accept its late-filed protest. The DRA filed its protest on the basis that a potential change in the control and divestiture of California American Water being addressed in Application (A.) 06-05-025 coupled with this financing application may adversely affect its capital ratio and

debt costs. DRA does not recommend the holding of a hearing so long that an order in this proceeding holds California American Water Company to a capital ratio of 60% debt to 40% equity, which is consistent with its Indenture and D.05-09-020.

DRA's late-filed motion and protest is granted on the basis that its identified issues are a valid concern in this proceeding. However, no further discussion of these issues need be made because this decision has already addressed both issues. The capital ratio issue is addressed in the prior general discussion section which adopts California American Water's proposal to maintain a capital ratio of approximately 60% debt to 40% equity. The debt costs issue is addressed in the prior competitive bidding exemption discussion requiring California American Water to provide in cost of capital proceedings testimony that substantiates the reasonableness of its interest rates applicable to the financing approved in this order.

### **VIII. Category and Need for Hearings**

California American water requested that this matter be categorized as ratesetting. By Resolution ALJ 176-3172, dated May 11, 2006, the Commission preliminarily determined that this was a ratesetting proceeding and that a hearing would not be necessary.

Notice of the application appeared in the Commission's Daily Calendar of May 9, 2006. Based on the record, we affirm that this is a ratesetting proceeding, and that a hearing is not necessary.

### **IX. Comment Period**

This is a contested matter in which the decision grants the relief requested. California American Water and DRA are the only parties to this proceeding and have agreed to reduce the comment period to five business days. Accordingly,

pursuant to § 311(g)(2), the otherwise applicable 30-day period for public review and comment is being reduced to five business days.

#### **X. Assignment of Proceeding**

John Bohn is the Assigned Commissioner and Michael Galvin is the assigned ALJ in this proceeding.

#### **Findings of Fact**

1. California American Water requests authority to issue during the next twelve months any combination of its long-term notes and shares of its common stock to one or more affiliated entities in an aggregate amount not to exceed \$187 million.

2. A late filed protest by DRA was accepted for filing and its concern addressed in this order.

3. DRA concurs that hearings are not necessary to the extent California American Water Company is held to the 60% debt to 40% equity ratio proposed by California American Water Company in its application.

4. California American Water has a reasonable need to issue \$187 million of securities during the next twelve months to finance capital expenditures, replace maturing debt, and redeem debt.

5. Resolution F-616 requires utilities to issue debt using competitive bids. The Resolution also provides for exemptions from the Competitive Bidding Rule for debt issues in excess of \$200 million and debt that must be obtained on a negotiated basis such as variable-rate debt.

6. California American Water does not have a bond rating.

7. California American Water seeks an exemption from the Competitive Bidding Rule to enable it to issue securities in a manner that is advantageous to

California American Water and its ratepayers, through a Financial Services Agreement.

8. GO 24-B requires utilities to submit a monthly report to the Commission that contains, among other things: (i) the amount of debt and stock issued by the utility during the previous month; (ii) the total amount of debt and stock outstanding at the end of the prior month; (iii) the purposes for which the utility expended the proceeds realized from the issuance of debt and stock during the prior month; and (iv) a monthly statement of the separate bank account that the utility is required to maintain for all receipts and disbursements of money obtained from the issuance of debt and preferred stock.

9. California American Water Company will issue and sell its common stock to maintain a capital ratio of approximately 60% debt to 40% equity that is consistent with its Indenture, D.05-09-020, its policies, and its Parent Company policies.

10. Application (A.) 06-05-005 does not propose, and today's Opinion does not authorize, any specific new construction or changes in use of existing assets and facilities.

11. Today's Opinion does not make a finding on the reasonableness of any resulting interest rate, term or conditions of debt issued by California American Water.

12. Notice of A.06-05-005 appeared in the Commission's Daily Calendar.

13. In Resolution ALJ 176-3172 issued on May 11, 2006, the Commission preliminarily determined that this proceeding should be categorized as ratesetting and that hearings would not be necessary.

**Conclusions of Law**

1. This is a ratesetting proceeding.
2. There is no need for hearings.
3. The application should be granted as requested.
4. The authority granted by this Opinion should not become effective until California American Water has paid the fees prescribed by §§ 1904(b) and 1904.1.
5. California American Water should not use the proceeds from the debt and common stock authorized by this Opinion to fund capital projects until it has obtained any required Commission approvals for the projects, including any required environmental review under CEQA.
6. The proposed debt and common stock securities are reasonably required to meet its forecasted 2006 capital expenditures and that, except as otherwise permitted in the order in the case of bonds, notes, or other evidences of indebtedness, such purposes are not reasonably chargeable to operating expenses or to income.
7. It is California American Water's responsibility to abide by and comply with any applicable environmental regulations for any capital improvement undertaken relative to this debt authorization.
8. California American Water should pay a fee in accordance with § 1904(b).
9. California American Water should report if financing activities pursuant to GO 24-B.
10. The following Order should be effective immediately so that California American Water may issue as soon as possible the debt and common stock authorized herein.

**O R D E R**

**IT IS ORDERED that:**

1. California American Water Company (California American Water) is authorized to issue any combination of long-term notes and common stock to one or more affiliated entities in an aggregate amount not to exceed \$187 million.

2. California American Water may issue any combination of long-term debt and common stock and for the purpose s identified in the bodyof this order that is consistent with its Indenture Decision 05-09-070.

3. California American Water shall provide testimony in its next cost of capital proceeding that substantiates the reasonableness of its interest rates applicable to the financing approved in this order.

4. California American Water's issuance of long-term notes authorized by this order is exempted from the Commission's Competitive Bidding Rule. In that regard, California American Water shall execute and deliver the Financial Services Agreement shown in Exhibit F to the Application to the Water Division within fifteen days after executing long-term notes.

5. California American Water shall remit to the Commission's Fiscal Office a check for \$33,500 as required by § 1904(b) of the Public Utilities Code. The decision number of this Order shall appear on the face of the check.

6. The authority granted by this Order shall not become effective until California American Water remits \$33,500 to the Commission's Fiscal Office.

7. On or before th 25<sup>th</sup> day of each month, California American Water shall report it financing activities being authorized by this order pursuant to General Order 24-B, to the Commission's Utility Audit, Finance and Compliance Branch.

8. This financing order does not authorize any capital expenditures or construction projects. California American Water shall comply with all



applicable environmental laws and regulations when planning and implementing any capital expenditure programs that are financed, in whole or in part, with the proceeds from the debt and common stock authorized by this Order.

9. Application 06-05-005 is closed.

This order is effective today.

Dated \_\_\_\_\_, at San Francisco, California.

**INFORMATION REGARDING SERVICE**

I have provided notification of filing to the electronic mail addresses on the attached service list.

Upon confirmation of this document's acceptance for filing, I will cause a copy of the filed document to be served upon the service list to this proceeding by U.S. mail. The service list I will use to serve the copy of the filed document is current as of today's date.

Dated July 6, 2006, at San Francisco, California.

/s/ TERESITA C.GALLARDO  
Teresita C. Gallardo

**SERVICE LIST IN  
APPLICATION 06-05-005**

**\*\*\*\*\* APPEARANCES \*\*\*\*\***

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